Banks' de-risking activity increases amid risk pressures
Listed credit market quarterly update - as at 30 June 2021
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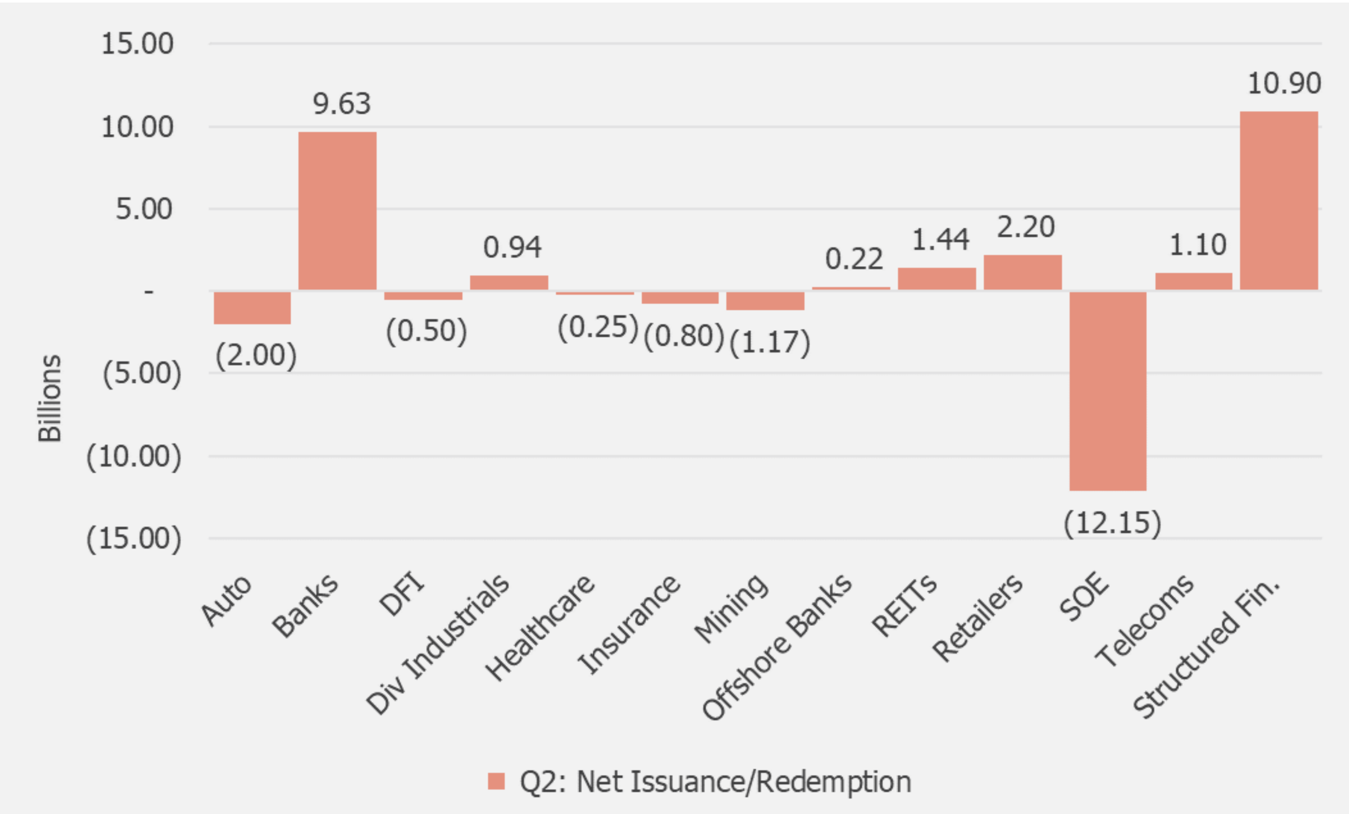
Overview

During the second quarter of 2021, we saw banks increasing their sell-down activity markedly, albeit in the short term. This de-risking activity follows the general deterioration of credit quality and migration of some debt capital market issuers to bank funding. The resultant pressure on bank capital is a major "bank de-risking" driver.

The banking sector took advantage of favourable credit spreads by issuing a net R9.63 billion of credit instruments in the market during the second quarter of 2021. The banks' activity in the primary market was a large contributor to the overall increase in total issuance from R29.0 billion to R65.8 billion over the period. More than half of the banks' total quarterly issuance (R41.0 billion) was through structured note sell-down activity. Of the R20.3 billion bank credit placed during the quarter, the largest issuer was Investec, with R6.6 billion, and the preferred term bucket was 5 to 7 years with R12.3 billion in notes placed.

The banks' de-risking exercise sharply increased during the quarter, signalling a potential or actual risk spike on their balance sheets. A total of R59.4 billion in listed debt maturities was scheduled for the second quarter, placing the market at R9.5 billion in net issuance for the period. Notably, the securitisation sector was a R10.9 billion net issuer, while the SOE (State-owned Enterprise) sector was a R12.15 billion net redeemer of credit. Although the issuance increase is encouraging, it is worth noting that market issuer diversity is shrinking markedly. *Figure 1* below shows the net issuance/redemption per sector.

Figure 1: Q2 - Net Issuance/Redemption



Source: JSE, Futuregrowth

State of the market

The market's net issuance position translated to a 1.62% increase in market size to R957 billion. The top four sectors, Banks, SOEs, Structured Finance and REITs, account for around 85% of the total outstanding credit. Depicted in *Figure 2* below is the sectoral contribution and evident market concentration, which continues to increase. Outstanding bank debt is made up of R321 billion bank credit and R108 billion structured notes. Bank credit is projected to increase significantly as FLAC (First Loss Absorbing Capital) gets phased in. The Structured Finance sector is made up of securitisation and Bank Repacks, and a third of the issued size is contributed by SA Homeloans vehicles.

Figure 2: Market size

Sector	Q1:2021	Q2:2021	Issuance Change %	Q1:Market Size %	Q2:Market Size %	Size Change %
Auto	31,014,000,000.00	29,014,000,000.00	-6.45%	3.29%	3.03%	-0.26%
Banks	411,267,097,168.54	429,581,690,021.21	4.45%	43.67%	44.88%	1.22%
DFI	1,500,000,000.00	1,000,000,000.00	-33.33%	0.16%	0.10%	-0.05%
Div Industrials	22,428,000,000.00	24,203,000,000.00	7.91%	2.38%	2.53%	0.15%
Healthcare	5,845,000,000.00	5,595,000,000.00	-4.28%	0.62%	0.58%	-0.04%
Insurance	26,000,000,000.00	25,500,000,000.00	-1.92%	2.76%	2.66%	-0.10%
Mining	9,331,856,089.00	8,807,063,091.00	-5.62%	0.99%	0.92%	-0.07%
Munis	16,651,666,664.36	16,539,166,664.36	-0.68%	1.77%	1.73%	-0.04%
Offshore Banks	4,283,000,000.00	4,498,000,000.00	5.02%	0.45%	0.47%	0.02%
Prop Developers	256,000,000.00	256,000,000.00	0.00%	0.03%	0.03%	0.00%
REITs	37,280,000,000.00	39,016,000,000.00	4.66%	3.96%	4.08%	0.12%
Retailers	2,006,000,000.00	4,206,000,000.00	109.67%	0.21%	0.44%	0.23%
SADC	2,052,000,000.00	2,052,000,000.00	0.00%	0.22%	0.21%	0.00%
SOE	297,982,443,119.08	288,280,209,635.13	-3.26%	31.64%	30.12%	-1.52%
Telecoms	18,896,000,000.00	20,246,000,000.00	7.14%	2.01%	2.12%	0.11%
Structured Fin.	55,068,451,047.25	58,361,604,639.93	5.98%	5.85%	6.10%	0.25%
	941,861,514,088.23	**957,155,734,051.63**	**1.62%**	**100.00%**	**100.00%**	

Source: JSE, Futuregrowth

A total of R281 billion of the market size is expected to mature within the next 12 months, of which half is bank issuance. The high expected refinance activity is largely due to recent short-term note placements by the high frequency issuers. Coupled with the excess credit demand, it is expected that there will be further spread compression in low default risk sectors. Credit investors are faced with the classic dilemma of choosing between *relative low default risk (below fair value spreads)* and *relative high default risk (above fair value spreads)*. Considering the default risk and the credit spread risk is a delicate balancing act. With the likelihood of further spread compression on the low default risk counterparties, amid all the uncertainty it is prudent to be overweight in these. Asset selection in the high default risk counterparties requires high conviction on either expected default risk improvement or excess credit spread premium. It is important to emphasise that our primary consideration is default risk - and spread risk is secondary.

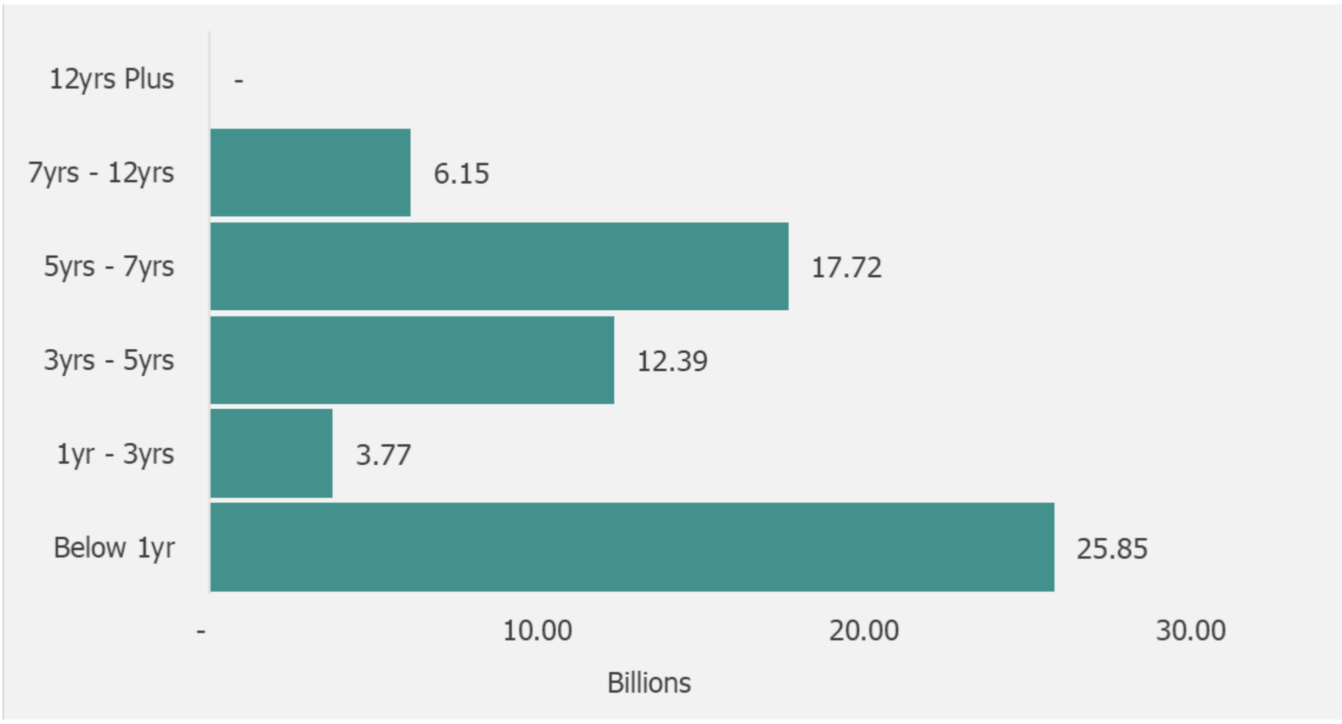
Primary market activity

The primary market short-term bias continues to prevail, with R25.8 billion (of the R65.8 billion) in the money market bucket. Bank structured notes contributed R14.75 billion of the issuance in the short-end term bucket. We also saw an increased appetite for the 7-year paper for the HQLA (High Quality Liquid Asset) counterparties during the quarter. This is caused by investors chasing yield as short credit spreads tighten. The R9.58 billion excess refinancing activity in the primary market was largely due to structured finance, as the sector sought to pre-finance R12.8 billion of maturities in the next quarter. TransSec issued R1.65 billion across class A, B and C notes, while SA Homeloans placed R3.6 billion through its different structured vehicles.

SOE second quarter maturities were R2.8 billion (R1.65 billion Rand Water and R1.2 billion TCTA) and only Rand Water managed to raise new funding: R1.7 billion via sustainability-linked bonds (SLBs) placed across the term structure. TCTA (WSP5), IDC (IDCG12), DBSA (DVFB21) and ESFR03 did not refinance R11.05 billion of collective maturities. We expect a continuation of the net redemption position for the sector until the existing negative sentiment lifts.

The REITs issuance surge can be attributed to the sector's preference for SLBs, which has driven demand. Investec Property Fund issued R1.085 billion, Growthpoint R750 million, Resilient R650 million and Equites R680 million during the quarter. Only Premium Properties were net redeemers of R120 million in the second quarter.

Figure 3: Q2 - Credit Issuance by Maturity Bucket



Source: JSE, Futuregrowth

Bank credit

Banks issued a total of R20.3 billion debt instruments and R21.03 billion risk sell-down structured notes (excluding repack notes). ABSA Bank (R10.5 billion) and Standard Bank (R6.34 billion) contributed R16.85 billion of the de-risking exercise. Although banks have sufficient capital buffers to absorb the increases in risk, the de-risking exercise is deemed to be a prudent capital management precautionary intervention. A total of R11.5 billion bank senior unsecured notes was issued during the second quarter, as well as R7.2 billion Tier 2 sub-debt and R1.5 billion AT1 (*see the tables below*).

Bank Senior unsecured

Counterparty	Term	Clearing Spread
FirstRand	7yr	145bps/Jibar
	10yr	154bps/Jibar
Nedbank	3yr	110bps/Jibar
	7yr	150bps/Jibar
Investec	3yr	115bps/Jibar
	5yr	135bps/Jibar
Grindrod	3yr	250bps/Jibar

Bank Sub-debt: Tier 2

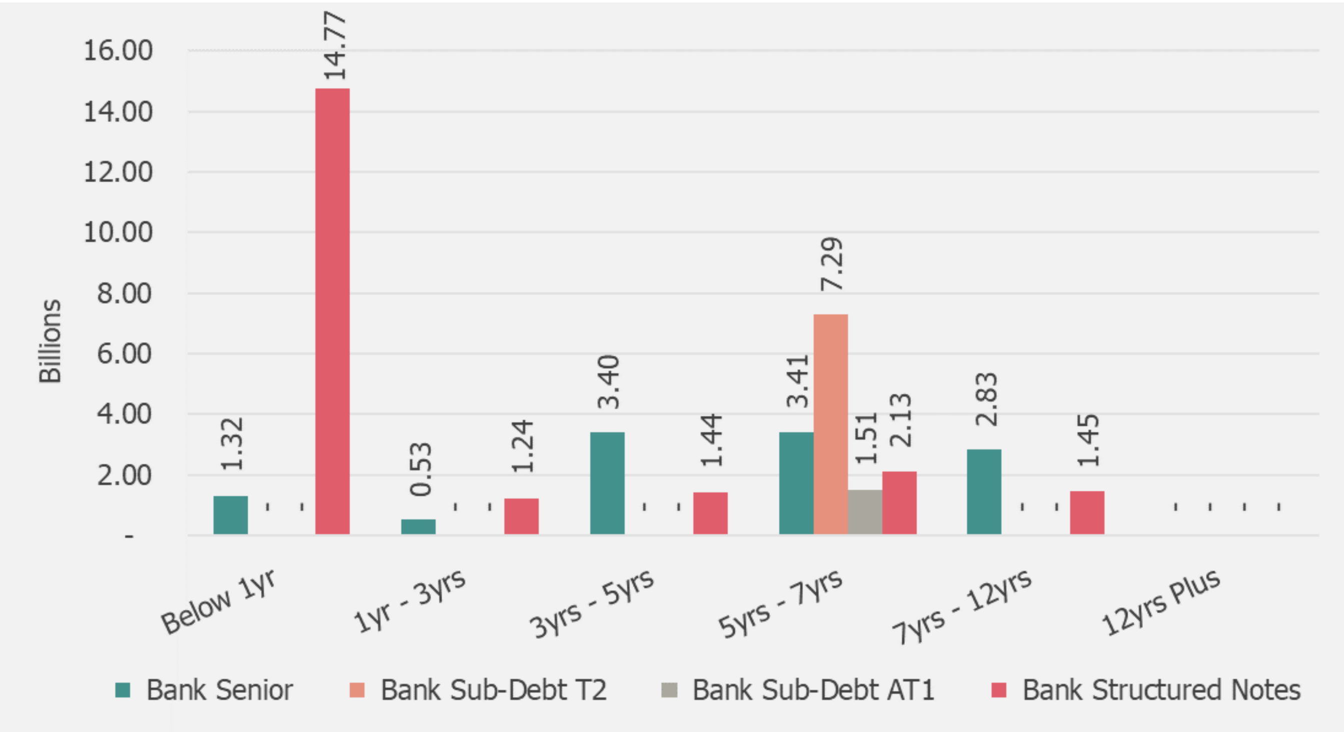
Counterparty	Term	Clearing Spread
FirstRand	5yr	234bps/Jibar
	5yr	80bps/R186
Nedbank	5yr	235bps/Jibar
STD Bank	5yr	210bps/Jibar

Bank Sub-debt: AT1

Counterparty	Term	Clearing Spread
Investec	5.25yr	440bps/Jibar
Nedbank	5yr (Green Bond)	410bps/Jibar

Nedbank and Investec AT1 paper has tightened by approximately 50 basis points (bps) since the beginning of the year. The same spread tightening is true for Tier 2. Bank paper holders have benefited substantially from this spread movement. The market is currently at pre-COVID bank spread levels. The market appetite for structured and ongoing low-default risk credit leads us to believe that further compression is likely.

Figure 4: Q2 - Bank Issuance



Source: JSE, Futuregrowth

Corporate issuances

The table below shows the counterparties in the other sectors that had credit placements. Pepkor's R2.2 billion placement led to a +100% market size increase by retailers, and MTN issued a total amount of R2.3 billion for the quarter.

Counterparty	Term	Clearing Spread
Pepkor	3yr & 5yr	152bps/Jibar & 170bps/Jibar
Rand Water	5yr, 7yr & 10yr	225/Jibar, 134bps/R2030 & 134bps/R213
KAP Industrials	3yr	200bps/Jibar
Merc Benz	1yr & 3yr	75bps/Jibar & 105bps/Jibar
MTN	1yr, 3yr, 5yr & 7yr	100, 164, 205 & 235bps/Jibar
Accelerate property	3.25yr	325bps/Jibar
Sappi	3yr	180bps/Jibar
Resilient	3yr	180bps/Jibar
Emira	3yrs	210bps/Jibar
BNP (SA)	6m	100bps/Jibar
Equites	3yr	165bps/Jibar

Secondary market activity

The total number of listed instruments with spread movement increased from 275 in the first quarter to 279 in the second quarter. Of these spread movers, 210 (193 in Q1:2021) tightened and 69 (82 in Q1:2021) widened (*see the tables below*). The average quarterly spread compression was 29.25bps (32bps in Q1:2021) and the trend continues to be largely short-term driven. Corporate spread tightening was driven by Autos, REITs, Div industrials, retailers and telecoms. The SOE tightening credit spreads were largely government guaranteed (Eskom and SANRAL) and included Cape Town Metro, Transnet and DBSA. Bank spread compression is noticeably driven by sub-debt instruments. This is largely a normalisation of aggressively widened bank sub-debt post-COVID credit spreads.

Num. Bonds Tightening

Term Bucket	Corporates	Structured Fin.	Financials	Sub-sovereign	Total
Below 1yr	25.00	1.00	25.00	0.00	**51.00**
1yr - 3yrs	34.00	10.00	43.00	9.00	**96.00**
3yrs - 5yrs	7.00	3.00	29.00	3.00	**42.00**
5yrs - 7yrs	0.00	0.00	6.00	3.00	**9.00**
7yrs - 12yrs	0.00	0.00	5.00	0.00	**5.00**
12yrs Plus	0.00	0.00	2.00	5.00	**7.00**
	66.00	**14.00**	**110.00**	**20.00**	**210.00**

Ave. Spread Tightening

Term Bucket	Corporates	Structured Fin.	Financials	Sub-sovereign	Total
Below 1yr	-44.77	-26.00	-34.30	0.00	**-39.27**
1yr - 3yrs	-27.98	-16.10	-42.88	-8.56	**-31.31**
3yrs - 5yrs	-21.29	-22.67	-24.93	-9.17	**-23.04**
5yrs - 7yrs	0.00	0.00	-12.50	-6.33	**-10.44**
7yrs - 12yrs	0.00	0.00	-3.70	0.00	**-3.70**
12yrs Plus	0.00	0.00	-18.00	-3.10	**-7.36**
	-33.63	**-18.21**	**-32.31**	**-6.95**	**-29.25**

Source: JSE, Futuregrowth

The market showed some dampening in the spread widening cycle: 69 bond spreads (82 last quarter) widened, of which 52 were bank senior unsecured instruments and insurer sub-debt. Evidently, there is investor loss of appetite for bank senior debt and a migration to sub-debt. This, too, is a reversal of the COVID shock trade that saw investors migrate from sub-debt to senior bank instruments. In the SOE sector, the 100bps widening in the 5 to 7-year bucket was driven by City of Tshwane (COT02 moved from 266bps/R186 to 366bps/R186) – and, in the 1 to 3-year bucket, by ACSA (AIR04 jumped from 130bps/R2023 to 253bps/R2023).

Num. Bonds Widening

Term Bucket	Corporates	Structured Fin.	Financials	Sub-sovereign	Total
Below 1yr	2.00	0.00	10.00	0.00	**12.00**
1yr - 3yrs	3.00	0.00	15.00	4.00	**22.00**
3yrs - 5yrs	1.00	0.00	13.00	3.00	**17.00**
5yrs - 7yrs	0.00	0.00	7.00	1.00	**8.00**
7yrs - 12yrs	0.00	0.00	6.00	3.00	**9.00**
12yrs Plus	0.00	0.00	1.00	0.00	**1.00**
	6.00	**0.00**	**52.00**	**11.00**	**69.00**

Ave. Spread Widening

Term Bucket	Corporates	Structured Fin.	Financials	Sub-sovereign	Total
Below 1yr	9.10	0.00	8.32	0.00	**8.45**
1yr - 3yrs	6.74	0.00	16.55	36.25	**18.79**
3yrs - 5yrs	41.00	0.00	11.47	19.00	**14.54**
5yrs - 7yrs	0.00	0.00	4.79	100.00	**16.69**
7yrs - 12yrs	0.00	0.00	7.67	12.00	**9.11**
12yrs Plus	0.00	0.00	1.00	0.00	**1.00**
	13.23	**0.00**	**10.79**	**30.73**	**14.18**

Source: JSE, Futuregrowth

The key takeout from the secondary market activity is that there is a general dampening of the spread widening and a general switch in appetite for bank credit from senior to sub-debt. We remain wary of deducing that this signals a reversal of high-risk aversion as this situation relates to one sector and cannot necessarily be applied to the rest of the market.

Credit rating actions

Below are the notable rating actions during the quarter:

- Transnet’s global scale rating (GSR) and National scale rating (NSR) were affirmed by Moody’s at Baa2 and Aa2.za respectively. The outlook was unchanged at negative. Fitch also affirmed Transnet’s GSR at BB- with a negative outlook.
- Sappi’s long term NSR was affirmed by Global Credit Ratings (GCR) at AA(za) and short term at A1+(za), both with a stable outlook.
- Moody’s downgraded City of Tshwane from Baa2.za to Caa1.za. The rating is still undergoing review for a further downgrade.
- Accelerate Property Fund received an NSR rating affirmation at A+(za) from GCR. The outlook also remains stable.

Credit market forward view

The position of banks in the debt capital markets has become even more critical with the SOE’s general inability to access the market. The next quarter’s refinance requirement is expected to be dominated by banks. The structured finance sector has partially pre-funded the R12 billion third quarter refinance requirement. In addition, there is a clear compression of the spread differential between senior bank debt and sub-debt. We also expect the bank de-risking activity to continue for as long as the market is characterised by credit investor risk aversion. As the high default risk counterparties migrate to bank funding, the resultant increasing risk exposure depletes banks’ capital buffers. Consequently, banks have to sell down some of the risk to the market as a capital management tool.

Figure 5: Maturity schedule

Sector	Q2:2021	Q3:2021	Q4:2021	Q1:2022	Total
Auto	3,500,000,000.00	4,924,000,000.00	880,000,000.00	8,359,000,000.00	17,663,000,000.00
Banks	31,700,510,375.79	27,963,920,075.00	10,963,510,361.33	69,848,232,164.64	140,476,172,976.76
DFI	500,000,000.00	-	-	-	500,000,000.00
Div Industrials	1,090,000,000.00	860,000,000.00	1,975,000,000.00	9,319,000,000.00	13,244,000,000.00
Healthcare	250,000,000.00	315,000,000.00	-	1,823,000,000.00	2,388,000,000.00
Insurance	800,000,000.00	1,000,000,000.00	500,000,000.00	4,957,000,000.00	7,257,000,000.00
Mining	1,174,792,998.00	-	74,740,250.00	4,097,055,996.00	5,346,589,244.00
Munis	-	-	-	-	-
Offshore Banks	385,000,000.00	2,061,000,000.00	560,000,000.00	427,000,000.00	3,433,000,000.00
Prop Developers	-	-	20,000,000.00	10,000,000.00	30,000,000.00
REITs	1,749,000,000.00	3,192,000,000.00	2,347,000,000.00	6,088,000,000.00	13,376,000,000.00
Retailers	-	-	537,000,000.00	-	537,000,000.00
SADC	-	-	-	1,560,000,000.00	1,560,000,000.00
SOE	13,929,933,483.95	5,939,685,731.67	3,110,801,840.00	19,494,215,608.00	42,474,636,663.62
Telecoms	1,250,000,000.00	850,000,000.00	-	3,337,000,000.00	5,437,000,000.00
Structured Fin.	-	12,846,967,102.00	3,163,012,432.00	11,783,034,734.24	27,793,014,268.24
	56,329,236,857.74	**59,952,572,908.67**	**24,131,064,883.33**	**141,102,538,502.88**	**281,515,413,152.62**

Source: JSE, Futuregrowth

Rand Water's successful refinance of RW21 is a huge positive for the SOE sector. It shows that the market does not blindly apply the negative sentiment across all issuers. Water boards are sufficiently profitable, with less balance sheet pressure compared to their peers in the sector. Futuregrowth continues to monitor City of Tshwane liquidity constraints. We believe that this is largely a standalone credit strain and we cannot assume the likelihood of such pressures on the other Metros without an in-depth analysis.

Unfortunately, the pandemic is still with us and therefore it is near impossible to project changes in the current trends. Banks and other HQLA issuers will continue to garner massive demand, and thus spreads may continue to compress.

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